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SUBJECT: LEBANON: GOL REACTION TO USG PROPOSAL FOR CASH
TRANSFER

REF: STATE 40894

Classified By: Christopher Murray, Charge d'Affaires. Reasons 1.4 (b)
and (d).

SUMMARY

11. (C) The GOL has reviewed U.S. proposals for conditionality on the USD 250 million cash transfer discussed at the Paris III Donors' Conference for Lebanon. The GOL response does not contain any surprises, and has the Lebanese most concerned about an increase in the gasoline tax. Arab donors have imposed no conditions. The World Bank is focusing on the power sector and the social safety net. The electricity sector is bankrupting the government, but ministers believe that the management can be changed without approval of Parliament. Money to fund the GOL through year end will be raised through issuing bonds. Otherwise, the Lebanese economy is not as weak as feared and may turn in modest growth of 1-2 percent 2007. End Summary.

GOL COUNTERPROPOSAL - NO SURPRISES

12. (C) Charge and Econoff met with Minister of Economy and Trade Sami Haddad on April 12 at the Grand Serail to discuss the GOL reaction to the four phases of conditionality which we had previously proposed (reftel). The GOL had prepared a counter-proposal, which has been faxed to the Department (NEA/ELA) Ann Donick). Among the U.S.-proposed conditions for disbursement, the gasoline tax remains the most worrisome issue for the GOL, for the obvious domestic political reasons. While the GOL does not want the USG to include the gasoline tax among the formal conditions, Haddad said that the GOL recognizes that there will have to be an increase in the gasoline tax before the end of the year. Overall, the GOL counterproposal contains nothing surprising, but rather predictable responses, such as a request that the first condition, the signing of the EPCA, be followed by a tranche of \$75 million rather than our proposed \$50 million. We reminded Haddad that the possible cash grant funds will be contingent on congressional and POTUS action on pending supplemental budget legislation.

CONDITIONS - "SIGNIFICANT HARMONY" WOULD HELP

13. (C) Haddad also said that he hoped that the USG could coordinate conditionality with the World Bank (IBRD), the

International Monetary Fund (IMF), the French, and the European Union (EU). The Arab donors, he said, are not imposing any conditionality. "Significant harmony" among donors would be ideal, because it would impose discipline and depoliticize the issue of conditionality. For that reason, Haddad admitted, he is disappointed that there are no conditions imposed by the Arab donors.

14. (C) Haddad noted that the IBRD is focused on Lebanon's power sector and the social safety net. The GOL is asking the IBRD to look at what it can do in other sectors beyond these two. He asked if USAID could do more in the area of promoting diversified agricultural productions, in order move the Lebanese away from the cultivation of subsidized sugar beets and tobacco.

ECONOMIC PICTURE; THE GOL IS BANKRUPT
BUT THINGS NOT AS BAD AS FEARED

15. (C) Haddad then reported more generally on the economy. The GOL is essentially out of money but planners are confident that they will be able to fund the budget through year-end. They expect to do this through issuing bonds ("over-issue, even if we have to pay a few more points" according to the Minister) while the market is liquid. Money from Paris is starting to come in: the GOL has now received \$77 million from the IMF, a \$100 million grant from the Saudis, and a \$50 million grant from Oman. In the coming weeks, there should be \$300 million from the UAE. An economic meeting of earlier that day had been chaired by the Prime Minister, joined by Finance Minister Jihad Azour, and Haddad himself. About half the meeting had been devoted to

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the GOL funding situation, and the other half to the power sector. Haddad said that Electricite du Liban (EDL), the electric utility, is bankrupting the government; "it's a disaster." He felt that the IBRD could have been more forceful and comprehensive in its recommendations in this sector; for example, its report completely ignored the need for more power generation. Haddad hopes to bring this up with IBRD again. Believing that the GOL can change the management of EDL without approval of Parliament, the GOL is looking at the possibility of getting an outside management contract, perhaps from Electricite de France, to run the company. Haddad specifically requested an opportunity to talk to USAID about options.

16. (C) In a final note the Minister pointed out that the economy is not as badly off as some fear. Growth for this year may come in at 1-2 percent, and there are promising signs for the tourism season. The banking sector is maintaining good liquidity, and deposits are growing, although not as quickly as in the past.

17. (C) Haddad said that he would depart Lebanon on April 13 for Washington for the World Bank/IMF meetings, as well as bilateral meetings with U.S. officials during the weekend.
MURRAY